In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 485

MARGARET PENN, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 47-53) is reported at 16 T.C. 1497. The opinion of the Court of Appeals (R. 71-76) is reported at 199 F. 2d 210.

JURISDICTION

The judgment of the Court of Appeals was entered October 23, 1952. (R. 77.) The petition for a writ of certiorari was filed December 6, 1952.

The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether depreciation deductions on a building erected by a taxpayer who also has a life interest in the property are to be computed under Section 23 (l) of the Internal Revenue Code and applicable Treasury Regulations at a rate based on the useful life of the building, as the court below held, or on the life expectancy of the taxpayer, as she contends.

STATUTE AND REGULATIONS INVOLVED

The pertinent portions of the applicable statute and Regulations involved are set forth in the Appendix, *infra*, pp. 8-12.

STATEMENT

The material facts as stipulated (R. 15-16) and as found by the Tax Court (R. 47-49) are as follows:

In 1913 taxpayer and her husband made a gift in trust to their daughter of a parcel of land and a building thereon, reserving to themselves and to the survivor a life estate in the property. The deed provided that during the continuance of the life estate the property should be rented; that the rentals be used to keep the building in good repair; and that the property should be managed by taxpayer's husband during his lifetime and thereafter

by taxpayer. The deed recited that the gift was made for the purpose of assuring to the daughter a fixed income after the death of taxpayer and her husband. (R. 48.)

By 1938, after the death of the husband, the building had become obsolete and untenantable and only one tenant remained. In that year taxpayer tore down the building and erected a new one at a cost to her of $17,628.45, in order "to get something out of her life estate". The useful life of the new building is fifty years beginning with 1938. At that time taxpayer was seventy-three years old and had a life expectancy of 7.26 years. (R. 48-49.)

In the years 1943 and 1944 taxpayer received rentals from the property of $5,680 and $6,900, respectively. In her income tax returns for each of those years she deducted "depreciation" on the building in the amount of $2,500, based upon her life expectancy. The Commissioner determined that the depreciation deductions were to be based on the useful life of the building, and adjusted taxpayer's net income accordingly. (R. 11, 13, 31, 41.) The Tax Court, in a decision reviewed by the full court, unanimously sustained the Commissioner's determination. (R. 49-53.) The Court of Appeals affirmed. (R. 77.)

ARGUMENT

The court below correctly held that for income tax purposes taxpayer must compute annual deductions for depreciation on the building involved here at a rate based on its useful life. Taxpayer has a life interest in the building but the fact that it was erected with her own money does not allow her to compute depreciation at a rate based on her life expectancy, as she contends. Section 23 (l) of the Internal Revenue Code (Appendix, *infra*, p. 8), which provides for depreciation deductions, requires that—

> In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. * * *

It is settled that an absolute owner of depreciable property must compute depreciation on the basis of the estimated life of the property, and the unequivocal language of Section 23 (l) requires that taxpayer, as life tenant, must use the same basis here. Such a practice gives effect to the Congressional purpose in allowing deductions for depreciation which, as stated in the applicable Treasury Regulation, is to permit the setting aside each year of an amount which, with the salvage value of the property, will equal the cost or other basis of the property "at the end of the useful life

of the depreciable property". See Section 29.23 (l)-1, Treasury Regulations 111 (Appendix, *infra,* pp. 8-9).

Prior to 1926 the taxing statutes were silent with respect to depreciation allowances in the case of property in which life and remainder interests were held by different taxpayers. In Section 214 (a)(8) of the Revenue Act of 1926, c. 27, 44 Stat. 9, it was provided that "In the case of improved real estate held by one person for life with remainder to another person, the [depreciation] deduction provided for in this paragraph shall be equitably apportioned between the life tenant and the remainderman", under the rules prescribed by the Commissioner.

This apportionment provision led to uncertainty and confusion, and Congress substituted an entirely different provision in Section 23 (k) of the Revenue Act of 1928, c. 852, 45 Stat. 791. That provision reads exactly like the one quoted above from Section 23 (l) of the Code and has been reenacted in every subsequent Revenue Act. The language used therein is plain and unambiguous. But even if it could be said to be ambiguous, the ambiguity would be dispelled by the Committee Reports accompanying the Revenue Act of 1928. The Report of the Senate Finance Committee (S. Rep. No. 960, 70th Cong., 1st Sess., p. 20 (1939-1 Cum. Bull. (Part 2) 409, 422-423)) states that "depreciation shall be computed as if the life

tenant were the absolute owner of the property—*that is, in accordance with the estimated useful life of the property*—and shall be allowed to the life tenant each year that he holds the property". (Italics supplied.) See also H. Conference Rep. No. 1882, 70th Cong., 1st Sess., p. 11 (1939-1 Cum. Bull. (Part 2) 444, 445).

Taxpayer contends that Section 23 (l) should be read as though it excepted a life tenant of real estate who erects improvements at his own expense, but the statute comprehensively covers all depreciable "property held by one person for life with remainder to another" and applies the same general rule regardless of who has defrayed the cost of the property and of whether the life tenant's life expectancy is greater or less than the useful life of the property. Congress provided for no exceptions, and if, as taxpayer urges, the statute works a hardship upon life tenants who erect improvements at their own expense, that is a matter which lies with Congress.

Rose v. *Grant*, 39 F. 2d 338 (C.A. 5th), and *Kissel* v. *Commissioner*, 15 B.T.A. 705, on which taxpayer relies, are not applicable here, for those cases arose under the Revenue Acts of 1918 and 1921 which contained provisions entirely different from those involved here. There is also no basis for taxpayer's reliance on Section 24 (d) of the Internal Revenue Code, which provides that "Amounts paid * * * as income to the holder of

a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time". Its effect is simply that the holder of such interest "may not set up the value of the expected future payments as corpus or principal and claim deductions for shrinkage or exhaustion thereof due to the passage of time". Section 29.24-8 of Regulations 111. This prohibition against amortization of the "value" of the life estate can scarcely be regarded as permitting the life tenant to depreciate over his lifetime the cost or other "basis" of property in which he owns a life interest.

CONCLUSION

The decision of the court below is correct; there is no conflict of decisions; and no question of general importance is involved. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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January, 1953.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(l) [As amended by Sec. 121 (c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. * * *

* * * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(l)-1. *Depreciation.*—A reasonable allowance for the exhaustion, wear and

tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. Due regard must also be given to expenditures for current upkeep. In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman. * * *

SEC. 29.23(l)-2. *Depreciable Property.*—The necessity for a depreciation allowance

arises from the fact that certain property used in the business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, or to land apart from the improvements or physical development added to it. * * *

* * * * * *

SEC. 29.23(l)-4. *Capital Sum Recoverable Through Depreciation Allowances.* — The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113 (a) and 114.) * * *

SEC. 29.23(l)-5. *Method of Computing Depreciation Allowance.*—The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual

installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and

such other information as the Commissioner may require in substantiation of the deduction claimed.

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